

Internal Revenue Service

Department of the Treasury

**District
Director**

1100 Commerce St., Dallas, Texas 75242

Date: **AUG 16 1995**

Employer ID Number:

Person to Contact:

Telephone Number:

Refer Reply To:

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code.

The information submitted indicates that you were incorporated in the State of [REDACTED] on [REDACTED]. Article IV of your Articles of Incorporation states that your purposes are:

- To enforce, supervise, put into effect and otherwise carry out such restrictions and covenants as are filed pertaining to properties in [REDACTED] Subdivision of [REDACTED] acres in [REDACTED] County;
- To promote and supervise the beautification, care, maintenance and upkeep of said subdivision;
- To own, operate, manage and maintain recreational facilities for use by the residents of said subdivision.

On [REDACTED], your Articles of Incorporation were amended to change your name to [REDACTED]. Your purposes according to this amendment have remained the same.

Article III of your Bylaws states that the owner of each fully assessed lot, during the period of his ownership, shall automatically be a member of your Association.

Article XII of your Bylaws states that each owner of an assessable lot is obligated to pay you annual assessments which are secured by a continuing lien upon the property against which the assessment is made.

Your 1024 Application for Recognition of Exemption states that your activities are the provision of services to the members of your subdivision. These services include:

- The maintenance of the roadways and esplanades within your subdivision;
- Street lighting;

- The maintenance of swimming pool and playground facilities;
- Security patrol;
- The distribution of a newsletter;
- The coordination of legal matters with Harris County officials; and
- The administration and enforcement of deed restrictions.

You are made up of [REDACTED] residential lots. [REDACTED] of the lots belong to residential homeowners and [REDACTED] belong to the builder-developer. Your population is approximately [REDACTED]. You claim that there are [REDACTED] elementary schools and [REDACTED] churches located within your boundaries.

The recreational facilities which you maintain are for the use of your members. These facilities consist of a swimming pool, clubhouse and tennis courts. You also maintain parks and playgrounds which are open to the public.

Your primary source of income is regular member assessments, late fees and reimbursements. You also receive interest on [REDACTED] investments.

Your expenses include the following:

Expense
Security
Pool Administration
Pool Repair

[REDACTED] [REDACTED] [REDACTED]

Your other expenses include street lighting, landscaping, administration and maintenance.

Your capital fund balance has risen from [REDACTED] at [REDACTED] to [REDACTED] on [REDACTED]. You had net income of \$[REDACTED] in [REDACTED] and \$[REDACTED] in [REDACTED]. [REDACTED] showed a net loss of \$[REDACTED].

Section 4.1(a) of your Declaration of Krisland Corp. states that: Each lot shall be used only for a living unit and a private garage or carport, and no lot shall be used for business or professional purposes of any kind.

Your correspondence dated [REDACTED] states the following:

There are approximately [REDACTED] acres within your boundaries:

- There are no commercial businesses, post offices, or libraries within your boundaries. The [REDACTED] elementary schools and [REDACTED] churches you have previously stated are within your boundaries actually are not within your boundaries;
- There are commercial reserves adjacent to your boundaries;
- The [REDACTED] School District serves your area;
- Since the State of [REDACTED] has granted you a non profit charter, it has approved your boundaries, and thus these boundaries create an independent

community:

- The services you provide are traditionally performed by a governmental unit;
- Your power to levy assessments is similar to the power of a municipality to levy property taxes;
- Your board of directors is similar to a city council;

You bear a reasonably recognizable relationship to an area ordinarily identified as governmental;

You do not maintain the exterior of any private residence;

Architectural control and deed enforcement is similar to building permits, codes, inspections and zoning used by municipalities;

In this correspondence dated [REDACTED], you have brought up the Rancho Santa Fe Association vs. U.S. court case. You have concluded that since you are a housing development which is coextensive with the community it serves, you are similar to the Rancho Santa Fe Association.

You have provided with this correspondence a map of the boundaries of your association. This map shows three churches and a school which are somewhat outside of your boundaries. There are two schools which are adjacent but outside of your boundaries.

Also provided is a copy of the agreement you have entered into with [REDACTED] County, which is dated [REDACTED]. This agreement calls for two "extra deputies" to devote [REDACTED] percent of their working time to the [REDACTED] subdivisions. You shall pay [REDACTED] County the sum of \$[REDACTED] for providing the "extra deputies" for the year beginning on [REDACTED].

Section 501(c) of the Code describes certain organizations exempt from Federal income tax under section 501(a) and reads, in part, as follows:

- (4) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes."

Section 1.501(c)(4)-1 of the regulations provides, in part, as follows:

- (a)(1) In general. A civic league or organization may be exempt as an organization described in section 501(c)(4) if -

- (i) It is not organized or operated for profit; and
- (ii) It is operated exclusively for the promotion of social welfare."

"(a)(2)(i) An organization is operated exclusively for the promotion of social welfare when it is primarily engaged in promoting, in some way, the common good

and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements *** The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office. Nor is an organization operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit.***"

Revenue Ruling 72-102, 1972-1 C.B. 149, describes an organization formed by a developer to preserve the appearance of a housing development and to maintain streets, sidewalks, and common areas for the use of the residents, which was found to be exempt under Internal Revenue Code section 501(c)(4). The rationale behind this decision was that the organization served the common good and general welfare of the entire community because it owned and maintained certain non-residential, non-commercial properties of the type normally owned and maintained by municipal governments. Administering and enforcing covenants for preserving the architecture and appearance of a housing development was incidental to the overriding public benefit.

Revenue Ruling 74-99, 1974-1 C.B. 131, modified Revenue Ruling 72-102. It provides that in order to qualify for exemption under IRC 501(c)(4), a homeowners' association must serve a community which bears a reasonably recognizable relation to an area ordinarily identified as governmental; must not conduct activities directed to the exclusive maintenance of private residences; and the common areas or facilities it owns and maintains must be for the use and enjoyment of the general public.

According to this revenue ruling, a community within the meaning of section 501(c)(4) is not simply an aggregation of homeowners' bound together in a structured unit formed as an integral part of a plan for the development of a real estate subdivision and the sale and purchase of homes therein. The term "community" as used in section 501(c)(4) has traditionally been construed as having reference to a geographical unit bearing a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof. The revenue ruling was intended only to approve ownership and maintenance by a homeowners' association of such areas as roadways and parklands, sidewalks, and street lights, access to, for the use and enjoyment of which is extended to members of the general public, as distinguished from controlled use or access restricted to the members of the homeowners' association.

According to Revenue Ruling 80-63, 1980-1 C.B. 115, no hard and fast rule can be applied as to what constitutes a "community," but that each case must be examined to determine whether the activities of the organization have sufficient community benefit to serve a social welfare purpose under IRC 501(c)(4). Although the area represented by an association may not be a community, if the association's activities benefit a community, it may still qualify for exemption. For instance, if the association owns and maintains common areas and facilities for the use and enjoyment of the general public as distinguished from areas and facilities whose use and enjoyment is controlled and restricted to members of the association then it may satisfy the requirement of serving a

[REDACTED]

Your Declaration of Krisland Corp prohibits your members from using any lots for business or professional purposes of any kind.

Because you are not a community, and you restrict the use of your swimming pool, clubhouse and tennis courts to your members, you are similar to the organization described in question 2 of the Revenue Ruling 80-63. It states that an organization that is not a community may not be exempt if it restricts the use of its recreational facilities to members of the association.

You are organized and operated for the private benefit of your members. The security services which you provide are over and above those services normally provided a neighborhood by governmental entities. [REDACTED] percent of your expenses in [REDACTED] were for these security services. Your members also benefit privately from your recreational facilities.

You also do not meet one of the basic requirements for exemption under section 501(c)(4) - that you operate in a non profit manner. The accumulation of [REDACTED] in capital funds clearly shows that you operate in a for profit manner.

Accordingly, it is held that you are not entitled to exemption from federal income tax as an organization described in section 501(c)(4) and you are required to file federal income tax returns on Form 1120.

As a homeowners' association, you may qualify for treatment under section 528. In this letter we are not ruling on the question of whether you qualify for treatment under section 528. However, if you believe you qualify for such treatment, you should file Form 1120-H when due.

If you do not agree with these conclusions, you may, within 30 days from the date of this letter, file in duplicate a brief of the facts, law, and argument that clearly sets forth your position. If you desire an oral discussion of the issue, please indicate this in your protest. The enclosed Publication 992 gives instructions for filing a protest.

If you do not file a protest with this office within 30 days of the date of this report or letter, this proposed determination will become final.

If you agree with these conclusions or do not wish to file a written protest, please sign and return Form 6018 in the enclosed self-addressed envelope as soon as possible.

If you have any further questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

[REDACTED]

District Director